United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLANT

76-7476

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United States Court of Appeals

FOR THE SECOND CIRCUIT

NEWBURGER, LOEB & CO., INC. as Assignee of Claims of David Buckley and Mary Buckley,

Plaintiff-Appellant-Appellee,

—against—

CHARLES GROSS, MABEL BLEICH, JEANNE DONOGHUE and GROSS & CO.,

Defendants-Appellees-Appellants,

NEWBURGER, LOEB & CO., a New York Limited Partnership, ANDREW M. NEWBURGER, ROBERT L. NEWBURGER, LEO STERN, ROBERT L. STERN, RICHARD D. STERN, JOHN F. SETTEL, HAROLD J. RICHARDS, SANDORD ROGGENBURG, ADOLPHUS ROGGENBURG, NED D. FRANK, ALEX AIXALA, FRED KAYNE, ROBERT MUH, PAUL RISHER, CHARLES SLOANE, ROBERT S. PERSKY, FINLEY, KUMBLE, UNDERBERG, PERSKY & ROTH, a Partnership, and LAWRENCE J. BERKOWITZ,

Additional Defendants-Counterclaims-Appellants-Appellees.

PLAINTIFF-APPELLANT-APPELLEE'S BRIEF

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TABLE OF CONTENT

TABLE OF CASES AND OTHER AUTHORITIES

TABLE OF CASES AND OTHER AUTHORITIES CONTINUED

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APPELLANT'S BRIEF

STATEMENT

This is an appeal by Newburger, Loeb & Co., Inc. from a judgment of the United States District Court for the Southern District of New York entered on September 1, 1976 (A541)*. Although the case began as a jury trial, there was a waiver of jury in mid-trial occasioned by the trial's great length and jury restlessness. The case continued as a bench trial before Hon. Richard Owen (A2738).

Newburger, Loeb & Co., Inc. appeals from the judgment entered after trial which dismissed its causes of action against defendants-appellees Charles Gross, Mabel Bleich and Gross & Co. for damages sustained involving the accounts of David and Mary Buckley, as well as its cause of action in its reply to defendants-appellees' counterclaim, for damages sustained as the result of a "trading account" handled by defendant-appellee Gross (A541). The District Court held that plaintiff and others, including

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* References preceded by the letter "A" are to pages of appellant Finley, Kumble's appendix. References are otherwise to pages of the transcript and exhibits.

its present and past officers and former legal counsel, were liable upon certain of defendants-appellees' counter-claims in the sum of $675,830 as the result of a "conspiracy" to wrongfully appropriate defendants-appellees' interests in Newburger, Loeb & Co., plaintiff's assignor, and certain securities belonging to defendant-appellee Gross (508).

Newburger, Loeb & Co., Inc. is a debtor-in-possession, functioning pursuant to the permission of the Bankruptcy Court as the result of a petition filed pursuant to Chapter XI of the Bankruptcy Act on November 11, 1974, approximately four months after defendant-appellant Finley, Kumble obtained permission to be relieved from further representing Newburger, Loeb & Co., Inc. in this case (A-F). Although trial of this action was originally stayed as the result of the petition (A-F), the stay was vacated by order of Referee Roy Babitt upon defendants-appellees' application. Judge Babitt referred all issues, involving the dischargeability and existence of any obligation to defendants-appellees, to Judge Owen for determination, along with the issues involved in the complaint.

Plaintiff-appellant's position upon this appeal is that it possesses a meritorious cause of action against Charles, Gross, Mabel Bleich and Gross & Co. for damages sustained by its assignor, Newburger, Loeb & Co., and by Newburger, Loeb & Co.'s assignors David and Mary Buckley, as the result of the improper handling of the Buckleys' accounts by Charles Jordon, a former partner of defendants-appellees. It contends that the District Court was in error in deciding that its causes of action should be dismissed. Plaintiff-appellant also contends that error was committed when the court dismissed the cause of action contained in its reply to defendants' counterclaim for damages sustained as the result of losses in a "trading account" handled by defendant-appellee Gross. Plaintiff-appellant joins in the argument which it anticipates will be advanced by additional defendants on counterclaim that (1) no actionable wrong was committed by Newburger, Loeb & Co., Inc. or its officers as a member of any "conspiracy" to wrongfully appropriate defendants-appellees' interests in Newburger, Loeb & Co.; (2) that it was error to assess damages for the alleged conversion of certain securities

which defendant-appellee Gross maintains belonged to him; (3) that the value of defendant-appellee's interest in Newburger, Loeb & Co. was improperly computed; and (4) that jurisdiction of defendant-appellee's claims failed to exist. Plaintiff-appellant also contends that the District Court erred in granting a post-judgment motion in behalf of additional defendants on counterclaim Robert Muh and Charles Sloane, relieving them of liability for punitive damages and for the alleged conversion of defendant-appellee Gross' securities (A571).

This action was instituted on February 18, 1971 by Newburger, Loeb & Co., Inc. against Charles Gross, Mabel Bleich and Gross & Co. (A-1). As originally conceived, this was an action for damages pursuant to Rule 10(b)(5) of the rules and regulations promulgated under the Securities Exchange Act of 1934. Plaintiff sued as the assignee of Newburger, Loeb & Co., which in turn was the assignee of David and Mary Buckley, for damages sustained by the Buckleys during the period when they maintained stock brokerage accounts at Gross & Co. (A-1). Gross & Co. was a brokerage firm which "cleared"

through Newburger, Loeb & Co. (A47). The damages sustained by the Buckleys arose principally as the result of purchases of Westec stock (E114). Plaintiff's assignor, Newburger, Loeb & Co., went unpaid as the result of the loss sustained in the Buckleys' accounts upon the suspension of trading in Westec (A1555). The Buckleys were not only unable to pay Newburger, Loeb & Co. but sustained a substantial loss of a "paper profit" realized prior to the suspension of trading in Westec (A1472). As the result of an amendment of the pleadings granted at the beginning of trial, plaintiff was permitted to sue for damages upon the assignment of the Buckleys' cause of action against Gross & Co., as well as upon the ground that defendants' conduct constituted a breach of the clearing agreement between Gross & Co. and Newburger, Loeb & Co. (183). A motion made in the course of trial to allege as an additional basis for recovery, false oral statements regarding an alleged discovery of a copper mine by Westec and to conform the pleadings to the proof, was denied.

The District Court was of the view that the

motive for the large number of transactions in the Buckleys' accounts was David Buckley's desire to speculate; that Buckley was aware of, and understood what was going on and that the account was in no way fraudulently manipulated by Gross & Co. (A513). The District Court also appears to have concluded that commencement and prosecution of plaintiff's claim was a step in a much larger plan to interfere with the rights of defendants-appellees (A527).

Finding a conflict between the testimony of former partners of Newburger, Loeb & Co., Ed Rubin and John Settel, as to whether the partnership knew about and had authorized Gross' maintenance of a "trading account", the court dismissed this cause of action as well (A528).

ISSUES PRESENTED

1. Whether the Trial Court erred in dismissing plaintiff's cause of action upon the ground that Gross & Co. did not "control" the Buckleys' accounts where it was

not contraverted that a partner of Gross & Co., Charles Jordon, suggested 80% to 90% of the transactions in the account; that the transactions in the account were repeatedly shown to have been for no other purpose than the generation of commissions; where the capital in the account was turned many times in excess of the ratio ordinarily relied upon to establish churning; where the account was shown to have consistently generated large commissions, paper profits and invariable losses; where it was shown that Charles Jordon failed to reveal his large position in Westec stock; and where it is not contradicted that Mr. Jordon falsely advised Buckley not to sell Westec stock several days before the market collapsed because of the claim, denied by Mr. Jordon, that Westec had just discovered a "copper mine"?

2. Whether defendants-appellees are liable to plaintiff's assignor for the loss sustained by plaintiff's assignor arising out of the Buckley accounts, by virtue of the "clearing agreement" between Newburger, Loeb & Co. and Gross & Co.?

3. Whether plaintiff's claims against

defendants were so lacking in merit that the bringing of the cause of action and the trial of this case before Judge Owen constituted malicious prosecution?

4. Whether the District Court erred in dismissing the claim based upon losses sustained in Newburger, Loeb & Co.'s trading account?

5. Whether the District Court erred in granting a motion made in behalf of additional defendants on counterclaim, Robert Muh and Charles Sloane, to be relieved of liability for punitive damages and for conversion of securities allegedly belonging to defendant Gross?

STATEMENT OF FACTS

Charles Gross had been a partner of Newburger, Loeb & Co. and was its managing partner during the period leading up to its reorganization and the formation of Newburger, Loeb & Co., Inc. (A642). Gross had formerly been a partner of Gross & Co., a firm which "cleared" through Newburger, Loeb & Co. (A47). Gross & Co. had

its offices within the offices of Newburger, Loeb & Co. (A83). Although Gross & Co. handled its customers' orders and was in sole personal contact with its customers, the clerical work involved in securities transactions, i.e., the buying, selling, paying for and delivering of securities, was handled by Newburger, Loeb & Co. (A 68).

David and Mary Buckley were customers of Gross & Co. (A762). Their accounts were handled by Charles Jordon, a partner of Gross & Co. (A 97). Relying upon the advice given to David Buckley by Jordon, the Buckleys engaged in a series of transactions during the years 1962 through 1966 which resulted in a loss to themselves and Newburger, Loeb & Co. upon suspension of trading in a security known as Westec in May of 1966 (E 114). During the interval between suspension of trading in Westec and its resumption in 1969, Charles Gross became a partner of Newburger, Loeb & Co. (A2293). At the same time, Mabel Bleich, who had been his secretary at Gross & Co., and Jeanne Donoghue, his sister, became limited partners of Newburger, Loeb & Co. (A4379).

The relationship between Newburger, Loeb & Co. and Gross & Co. was the subject of a written "clearing agreement" (Exhibit 2; A51). Paragraphs 7, 8 and 11 of the clearing agreement are relevant. In substance, they provide that any liability as the result of "errors" by Gross & Co. was the responsibility of Gross & Co. The agreement also provides that all orders of Gross & Co. were subject to the applicable law. In other words, Gross & Co. agreed that it would not place orders with Newburger, Loeb & Co. which were in violation of the Rules of the New York Stock Exchange, the Securities Laws of the United States or other laws. The clearing agreement specifically provides that Gross & Co. would not violate certain sections of the Rules of The New York Stock Exchange, including Rule 504, commonly known as the "know your customer" rule.

The testimony of Robert Newburger established that various sums of money were owed to Newburger, Loeb & Co. in 1970 by customers, including the sum of approximately $380,000 upon the margin accounts and other accounts of David and Mary Buckley (A234). Newburger, Loeb & Co.'s effort to obtain payment from the Buckleys, resulting

in the assignment to it of any claim the Buckleys had against Gross & Co., was explored at length.

Shortly after the middle of 1966, when the account first went into deficit, Charles Jordon contacted Buckley (A232). A series of meetings followed between Buckley and Leo Stern and Charles Jordon, as well as meetings between Buckley, his attorney John Ryan of the Webster Sheffield firm, and Leo Stern (A329). Buckley's financial situation was such that even if he was indebted to Newburger, Loeb & Co. he could have avoided payment through the filing of a (A390) bankruptcy petition (A380). When the initial demand for payment was made, Buckley discussed the facts with Ryan (A374). It was Ryan's conclusion that the account had been churned; that bad advice had been given to (A401) Buckley by Jordon and that Buckley could avoid liability by filing a bankruptcy petition (A391). During 1967 and 1968, other than attending meetings with Buckley and Ryan, Newburger, Loeb & Co. did nothing to compel payment (A398). Trading in Westec had been suspended and the stock could not be sold (A375). It was tacitly agreed

to wait until the suspension was lifted, if it ever was; to see what the price of the stock would be -- hoping that if the stock rose, there would be no deficit and conceivably no loss to the Buckleys (A401).

When trading in Westec stock was reopened (A407) in May of 1969, it began selling at a price of approximately $10 per share (A333). It had been selling at around $45 per share when trading was suspended and had been selling as high as $60 per share during its peak (A326). Westec stock did not rise to a level sufficient to eradicate either Newburger, Loeb & Co.'s loss or the Buckleys' loss. During September of 1969, Golenbock & Barell, attorneys who had been introduced to Newburger, Loeb & Co. by Charles Gross and who had represented Gross & Co. since 1959, began efforts to compel payment by the Buckleys (A344). The matter was handled by Arthur C. Silverman, an attorney associated with Golenbock & Barell, and Richard Miles, the compliance officer of Newburger, Loeb & Co. (A1557). An arbitration proceeding was commenced in behalf of Newburger, Loeb & Co. before the American Arbitration Association (Exhibit 25;A346). The Buckleys'

attorneys responded by asserting that the Buckleys not only had no money, but that the account had been "churned" and bad advice had been given. Specifically, they alleged that Buckley had been persuaded not to sell during a telephone conversation between Buckley and Jordon shortly prior to suspension of trading in Westec (Exhibit 28; A383; A410; A415).

Charles Gross continued to be the managing partner of Newburger, Loeb & Co. until the late summer of 1970, at which point he was succeeded by Fred Kayne (A2293). Shortly thereafter he gave notice dated August 30, 1970, that he was resigning from the firm and wanted to withdraw his capital (E856).

It is anticipated that the efforts to reorganize Newburger, Loeb & Co. will be discussed in detail in another brief. The loss sustained by Newburger, Loeb & Co. as a result of the Buckley account was the subject of charges made and threats uttered in an effort to compel or "coerce" Gross, Bleich and Donoghue to go along with the reorganization. Just as Gross, through his attorneys, was relying upon Section 98 of the Partnership Law and

the fact that Mabel Bleich and Jeanne Donoghue would follow his instructions, Newburger, Loeb & Co.'s attorneys were marshaling every bit of legal argument available. Robert Persky, formerly a member of the Finley, Kumble firm, took over efforts to collect upon the Buckley account from Arthur C. Silverman (A66). Persky was able to induce the Buckleys to settle with Newburger, Loeb & Co. through a payment of $50,000.00, as opposed to the $380,000 due, and an assignment of Buckleys' claims against Gross & Co. Releases were Executed, assignments were prepared and the arbitration was concluded (Exhibits 37-48; E127).

Whether the Buckleys had a valid cause of action against Gross & Co. and whether Newburger, Loeb & Co. had an independent cause of action against Gross & Co. by virtue of the clearing agreement was explored at length on trial. Although Charles Gross' motives for invoking Section 98 of the Partnership Law had no effect upon the issue of whether he acted improperly, it would be wrong to conclude that examination into

the motives for bringing suit as the assignee of the Buckleys against Gross did not color the court's appraisal of the claim.

Buckley was, during the period when he was dealing with Gross & Co., and is an intelligent, well-educated son of a wealthy man (A244). During the period 1962 through 1966, as well as at the present time, he lived principally upon gifts to himself, his wife, and their five children, from his father. He was out of work at the time of trial, and had been unemployed for a substantial period. Buckley had attended Cornell University and had received a Batchelors Degree in Economics (A180). He had also received a Post-Graduate Degree in Business (A181). When he left school in 1954, he became a trainee at Lever Brothers (A181). At that point, he was approximately 23 years of age. When he first met Jordon and became a customer of Jordon's firm, Goodkind, Newfeld & Jordon (A251), he was 29. In 1962, when Jordon went to Gross & Co., taking the Buckley account with him, Buckley was 31 years of age, married and had 2 children (A160).

Buckley's salary as an employee of Lever Brothers ranged between $15,000 and $30,000 per year during 1962 through 1966 (A769). His father was in the practice of augmenting Buckley's salary by giving Buckley, his wife, and each one of their children, $5,000 worth of Georgia Pacific stock each year (A160). Buckley would deposit the Georgia Pacific stock into his Merrill Lynch account; sell the stock; and use the proceeds, as well as his salary and borrowed money to finance his purchase of stock in his accounts with Gross & Co. (A175).

Although a broker is required to learn the essential facts regarding each customer by virtue of Rule 504 (presently Rule 405) of the Rules of The New York Stock Exchange, no information regarding Buckley is set forth upon the account card which Buckley signed upon the opening of his account with Gross & Co. (Exhibits 4, E 6). In addition, according to Buckley, there was no conversation between Buckley and Jordon regarding his investment objectives when the account was opened, although Buckley did wish to make

money, wished to do so as quickly as possible and did wish to "make it on his own" (A235; A768). Although defendants contended that Buckley had a $500,000 tax loss carry forward and Jordon testified that he thought this was so (A774), it was established that this was not true (A157). Buckley testified that he had no such loss until the transactions in question occurred.

As the Trial Court noted, the Buckley accounts contained a large number of transactions (A354). In addition, there is a high ratio of turn over of capital, which, in some quarters, was as high as five times (A562). During the period 1962 through 1966, Buckley's capital was invested and reinvested or "turned over" on the average of 7 times per year (A562).

According to Buckley, between 80% and 90% of the transactions in the account occurred as a result of the suggestion of Jordon (A431). Buckley rarely went to Jordon's office, but they would speak over the telephone as frequently as 6 to 7 times or 9 to 10 times per day (A421; A 776). According to Buckley's testimony, Jordon and

Buckley would discuss the purchase and sale of securities and various investment ideas reaching Buckley from outside sources, but outside ideas not generated by Jordon culminated in transactions on only a few occasions (A182; A 433). Buckley testified that there were frequent occasions when he would turn down Jordon's recommendation to buy or sell securities. Buckley's purchases on a single day frequently exceeded his annual income.

Buckley testified that toward the end of 1965 he began to purchase, at Jordon's suggestion, the securities of a corporation known as Westec (A199). According to Buckley, he became "concerned" about Westec during 1966, since the financial statement of Westec for the year 1965 was not issued on time, and when it was issued it appeared to be misleading since it reflected as a profit, monies realized upon the sale of one of its assets (A221). According to Buckley, he repeatedly reflected his concern about Westec in conversations over the telephone with Jordon (A220). But according to Buckley, Jordon allayed his fears by claiming that he had an "inside track" with the public relations girl at Westec and was receiving

secret information with respect to the affairs of the company so that Buckley need not worry (A220). Buckley testified that when the Westec financial statement for the year ending 1965 was finally issued, he showed it to a friend who was connected with another brokerage firm (A359). After reviewing it, the friend advised him that in his opinion "it smelled to high heaven" (A359). At or about this point, Buckley was holding approximately 11,000 shares of Westec which he had purchased at approximately $10 per share from Gross & Co. clearing through Newburger, Loeb & Co. (A323). In addition, he held another 2,500 shares of Westec stock in his account at Merrill Lynch (A323). Buckley testified that the information he received from his friend upon review of the Westec financial statement was the first solid information that he received indicating that he should sell the stock. According to Buckley, he then telephoned Jordon by long distance telephone call from Wichita, Kansas, where Buckley was on business (A360). He told Jordon that he had made up his mind to sell Westec (A361) He told Jordon that he had already sold 500 shares of Westec which he had in his

Merrill Lynch account (A363). Jordon responded by advising Buckley of a strange "coincidence"; that he had spoken that day with the public relations girl at Westec; that he had learned that there had been (A370) favorable drillings in the Westec copper mine in Chile; that a group was spreading rumors calculated to depress the price of the stock so that they could later purchase it cheaply and make a killing and that in his opinion Buckley should not sell. Jordon also advised Buckley that to dump his 11,000 shares upon the market would have the effect of further depressing the price of the stock. Buckley testified that based upon the telephone conversation with Jordon, he decided not to sell (A365).

Charles Jordon testified upon trial that he had never advised Buckley not to sell Westec; that he had never advised Buckley of a so-called "copper strike"; and that he had never advised Buckley of a group "spreading rumors" (A841). Jordon did not advise Buckley in the course of their telephone conversation or at any time, that he and members of his family individually owned (A793) 10,000 shares of Westec stock (A239); or that Jordon

was "hedging" or short against the box, so that if the stock went down Jordon's loss would not be as devastating as Buckley's (A239; A793)

Several days after the telephone conversation between Jordon and Buckley which Buckley placed from Wichita, Kansas, trading in Westec stock was suspended by the American Stock Exchange (A178). David and Mary Buckley lost their "paper profit" and became indebted to Newburger, Loeb & Co. in the sum of approximately one-quarter million dollars.

An expert witness, David Marcus, testified that he had reviewed the Buckley accounts (A555). According to Marcus' testimony, the sole beneficial result to anyone of the turn over in the account was the generation of commissions (A571). In the years 1962, 1964 and 1966 there was a loss (A237). There was a small profit in 1963 of $24,973 and in 1965 of $2,401 (A238). Although there was a paper profit, Marcus testified to a rapid fibrillation in the account (A569). According to Marcus, Buckley's account was "churned" and was not "a trading account." Marcus

indicated that the decision to buy and sell did not appear to have any connection to the advance or decline in the price of the stock; frequently stocks were sold even though their price rise was barely sufficient to cover the commission, or after paying the commission, resulting in a loss (A560).

Arthur C. Silverman and Richard Miles were called as witnesses in behalf of defendants-appellees. Both took the position that the churning claim lacked merit and was simply utilized by Buckley to avoid (A1499) paying his indebtedness to Newburger, Loeb & Co. (A1601), although Miles indicated upon cross-examination that in view of the rate of turn over of capital, the (A1528) possibility existed that the account had, in fact, been "churned." John Ryan, Buckley's attorney, testified at in his opinion a meritorious "churning claim" existed (A410).

POINT I

DISMISSAL OF APPELLANT'S COMPLAINT AS AMENDED WAS CLEARLY ERRONEOUS

Rule 52(a) of the Federal Rules of Civil Procedure permits this court to set aside findings of fact made by the District Court where they are "clearly erroneous." In addition, application by the trial court of incorrect standards to reach a conclusion involves a "question of law" within this court's purview. United States v. Singer, 374 U.S. 174, 192 (1962). We believe that reversal is warranted by incorrect conclusions reached and mis-application of standards with respect to the determination of whether brokerage accounts have been "churned" and whether liability exists upon the basis of a clearing agreement between an "introducing" and a "clearing" firm. The trial court ignored testimony which directly demonstrated control by Gross & Co. over the Buckley accounts; ignored evidence with respect to the excessive trading in the account; placed undue emphasis upon the Buckleys' "paper profit" and paid no concern to the proof that Gross & Co. fraudulently dissuaded Buckley from selling out several days prior to suspension of trading in the account, thereby directly causing loss to Buckley and to plaintiff's assignor.

Although Circuit Courts of Appeals in other areas have reviewed the standards for determining the existence of a cause of action based upon "churning" [Hecht v. Harris, Upham & Co., 430 F. 2d 1202 (9th Cir. 1970)], and although District Courts within the circuit have discussed the cause of action in various decisions [Moscarelli v. Stamm, 288 F. Supp. 453 (E.D.N.Y. 1968)], this court has not issued an opinion dealing with the cause of action. The decision of the 9th Circuit in the Hecht case, together with the Note, "Churning by Securities Dealers", 80 Harvard Law Review 869 (1967) contain the most exhaustive analysis and discussion of the nature of the cause of action and the standards to be applied to determine if churning exists.

Churning is a species of fraud whereby a broker having obtained, as in this case, the "trust" of the customer (A 239) abuses said trust. A breach of a fiduciary relationship existing between the broker and the customer also occurs. The essence of churning is the manipulation of the account by the broker for his own advantage -- not the customer's advantage; through fraudulent and numerous transactions disproportionate to the size and nature of the account; extensive trading

for the primary advantage of the broker -- not the customer.

Hecht v. Harris, Upham & Co., supra, p.1207; Note, Churning by Securities Dealers, supra, 869.

Churning is a violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10(b)(5). It is prohibited by 17 C.F.R., Section 240.10b-5. The churning of an account is also in violation of Rules of the New York Stock Exchange, including Rule 435.

The trial court rejected the view that Section 10(b) of the Securities Exchange Act of 1934 or regulation 10(b-5) had been violated, essentially because of the view that each transaction in the Buckley accounts was authorized by David Buckley (A513). The court relied upon David Buckley's desire to speculate, his knowledge regarding the market, his contact with other brokers and his reading of materials in the field. But in so doing, the court ignored proof that despite Buckley's intelligence, his eagerness for financial gain and his general knowledge-ability with respect to the securities field*, his account was fraudulently manipulated and handled for the prime purpose of benefiting Gross & Co.

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*Disputed by Buckley (A434).

The court concluded that Buckley controlled the accounts. Although control by the broker over the transactions in an account is essential to a finding that the account has been churned, the fact that the accounts were non-discretionary is not dispositive of the issue. The evidence showed and the trial court's opinion indicates that the vast majority of all transactions in the accounts were suggested by Gross & Co., although Buckley did authorize every transaction. As indicated in the Note, Churning by Securities Dealers, "If all of the transactions in the account were made pursuant to the dealer's recommendation, the 'ultimate fact' of control may be established directly, and a finding that most of the transactions followed his recommendations is generally sufficient." Control was also shown to exist by proof regarding the frequency of telephone communications between Jordon and Buckley. According to Buckley, there were telephonic communications 6 to 7 or 9 to 10 times per day (A421). This was not substantially contradicted by Jordon (A777). As indicated in the Note, Churning by Securities Dealers;

> "... the fact that the dealer kept in frequent touch with the customers as a regular part of his business"

should be considered. More to the point, however, and

showing control beyond a doubt, was the testimony regarding Buckley's futile efforts to sell his position in Westec during the period prior to suspension of trading. Jordon, who had induced Buckley to buy and continue to buy the security, adopted a plan to induce Buckley not to sell. Buckley's fears were "allayed." Finally, when Buckley had made up his mind to sell, he was persuaded by Jordon not to do so in the course of the telephone conversation which Buckley placed with Jordon from Wichita, Kansas, through false words regarding copper mine strikes and groups spreading rumors to depress the stock (A220; A359; A323; A360-361; A363; A370; A365; A239). As indicated in the Note, Churning by Securities Dealers:

> "If the customer's complaints about the operation of the account are met by soothing explanations not accompanied by any change in the account, control may also be found, especially when the conduct is accompanied by disregard of a specific instruction made by the customer in conjunction with his complaints."

Churning also constitutes a breach of the fiduciary obligation existing between broker and customer where, as here, it can be seen that direct benefit accrued to the broker through preventing the sale, as

where the broker desired to prevent a depressing effect upon the price of the stock which could occur if the stock was sold because of his own holdings in the stock. Little doubt can exist upon the issue of either "control", fraud or breach of trust (A432).

The fact that Buckley authorized each and every trade and was well educated, intelligent and knowledgeable is only some evidence of control -- well counterbalanced by the proof that the great bulk of all transactions in the account were recommended by Jordon; and that Jordon effectively decided when to buy and when to sell the Westec stock in defiance of Buckley's wishes and in furtherance of his own hope for gain. As indicated in Clostermann v. Gates Rubber Company, 394 F2d 794, 796 (9th Cir. 1968);

> "A finding is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire evidence, is left with a definite and firm conviction that a mistake has been committed."

Churning has been found to exist despite customer authorization of the trades, Hecht v. Harris, Upham & Co., supra, at 1209; Although it is true that

in that case the customer was specifically found not to have had "sufficient competence to understand whether the frequency and volume of the transactions might be 'excessive'" (id).

The degree of education, intelligence and knowledgeability found by the trial court to exist is not dispositive. Churning does not require a finding of customer's naivete. As indicated in the Note, Churning by Securities Dealers;

> "But the apparent lack of consistency in background among persons considered naive -- or, conversely, not naive -- suggests that the 'finding' of naivete is more a device used to justify a decision than a useful guide for future cases.

The Note goes on to indicate SEC findings regarding churning in cases involving professional people, attorneys and even "a state official in charge of securities."

The trial court found that "there were a great number of transactions over a three-year period"

(A513), but ignored all statistical proof and expert testimony regarding said transactions. The testimony of David Marcus, Vice President of the Legal and Compliance Department of Drexel, Burnham & Co., Inc. established that the hallmarks of churning, i.e., an excessive "turn over ratio", frequent in and out trading, benefits to the broker with little, if any, profits to the customer (A550-A553), exist in this case. Marcus made an analysis of the Buckley accounts (Exhibits 9 through 21; A555; Exhibit 22, E36; Exhibit 23, E37) and prepared a chart showing his analysis (Exhibit 49, E151). Marcus testified "... that there were frequent transactions where purchases were made, sales of the securities were effected within a short time thereafter at little or no profit to the client" (A560). According to Marcus, "in some instances, in fact, the same security was purchased, sold and re-purchased within a fairly short period of time without any appreciable change in price either way." According to Marcus, "the turn over rate in any given quarter was generally fairly high, and this carried throughout the period until 1966 when activity in the account diminished substantially...." (A561). Excluding quarters where there was little or no activity, i.e., the first quarter

of 1962 and the second and third quarter of 1966, there was, according to Marcus, throughout most of the period, turn over ratios which were "quite substantial" (id). Marcus testified that during 1964 the turn over ratio was 15 times (id) and that the annual or average rate each year was "something in excess of 5 times ...." Averaging the turn over ratio arrived at for each quarter, the turn over ratio was, according to Marcus, "7 times per year" (A562). A calculation made by Mr. Buckley showed that there were total sales in excess of $5 million worth of securities in his account during the period 1962 through 1966 and a total of 1,110 transactions (Exhibit 23, E37), invariably resulting in a loss or a small profit (id). The commission earned by Gross & Co. as a result of the aforesaid transactions was in the neighborhood of $75,000 gained (A355). Marcus was of the view that the account was churned (A588).

Given the ingredient of control, analysis of the Buckley account shows that illegal churning exists. As stated in the Note, Churning by Securities Dealers;

> "Nonetheless, it is possible to generalize from the SEC cases that a complete turnover more than once every two months is likely to be labeled excessive, and this conclusion appears reasonable.

Coupled with the existence of in and out trading, the conclusion to be reached is that the account has been churned, or that the customer simply does not know what he is doing.

The trial court observed that "on paper" the accounts were "highly profitable" until trading was suspended in Westec. This is not relevant. The paper profit did not occur as a result of churning accounts, but arose out of the advice given to purchase Westec stock and not to sell it during the period when it had its meteoric rise. As the Note, Churning by Securities Dealers indicates;

> "Many dealers charged with churning have protested that the customer's account showed a net profit, but the SEC has consistently stated that this is not a sufficient defense."

In a foot note to the court's opinion, the trial court drew an adverse inference from the ad damnum clause which exceeded the churning claim raised in the Buckleys' behalf in response to Newburger, Loeb & Co.'s demand for arbitration. Whereas $75,000 had been originally claimed, the complaint prior to amendment sought damages equivalent to the loss sustained by the Buckleys when trading in Westec was suspended and the loss sustained by Newburger, Loeb & Co. by virtue of the deficit in the Buckleys' account. While the measure of damages in a churning case is difficult to apply, it is not limited to the commissions earned by the broker. The recovery can include the loss sustained as a result of the broker's fraud and breach of t[illegible]. Where, as here, the Buckleys can be shown to have been specifically injured through fraudulent advice given in the course of the telephone conversation from Wichita, Kansas to New York, it would be absurd to limit the recovery to the commissions earned in the account. Similarly, where Newburger, Loeb & Co. was damaged in that it was not paid by the Buckleys, the measure of damages should be the amount lost.

The facts of this case and the opinion below also show that it is wrong to join a churning claim with a cause of action for malicious prosecution or conspiracy to do so along with other wrongful acts. It is far too easy in a trial awash with testimony of base motives in bringing suit and conflicting evidence regarding the certainty whether a cause of action exists at various stages and upon the part of various attorneys, to be subtly and wrongfully influenced into believing that an element such as "control" may not exist because of dislike for an attorney's "tactics." This does harm to the legal system. A case should stand or fall on its merits; not the conduct of attorneys involved in its prosecution.

One of the arguments made below, although not relied upon by the trial court in its decision, was the view that Newburger, Loeb & Co. was a joint tort feasor if churning occurred and barred, as a matter of law, from suing upon an assignment of the Buckleys' rights. This argument has no merit. Newburger, Loeb & Co. possessed a valid cause of

action in its own right, not only by virtue of its status as a purchaser of securities, but also as a result of the breach of the clearing agreement. The testimony also failed to show any conduct upon Newburger Loeb's part from which it could be concluded that it was "in pari delicto" with Gross & Co. According to defendants, a clearing firm may not sue the introducing firm for damages sustained by virtue of churning, nor take an assignment from the injured customer and sue thereon. This is not the law.

In American Bank & Trust Co. v. Barad Shaff Securities Corp., 335 F.Supp. 1276 (S.D.N.Y. 1972), the court concluded that upon the insolvency of a customer of a bank, the bank became a purchaser with standing to sue brokers who had sold the stock to its customer, where, as here, plaintiff had received and paid for the stock. Judge Curfein denied defendant's motion to dismiss the bank's cause of action. Although the case involved liability arising out of a violation of Section 5, the court's reasoning is apposite. The court stated;

"One who buys for another may be a 'purchaser' under § 10(b) of the 1934 Act, at least for purposes of suit against his own customers if they fail to reimburse him. A.T. Brod & Co. v. Perlow, 375 F.2d 393 (2 Cir. 1967). Granted that a broker or a bank, acting for a customer, may be a 'purchaser' under the securities laws, the question still remains here whether American is a purchaser 'from him,' i.e., from the seller of the security lacking registration.

Technically it may be argued that the circumstance of default by Wanderon converted American into an involuntary purchaser from the moving defendants. Cf. Vine v. Beneficial Finance Co., 374 F.2d 627, 635 (2 Cir. 1967), cert. denied, 389 U.S. 970, 88 S.Ct. 463, 19 L.Ed.2d 460 (1968). But the question of statutory construction affecting the securities laws should not be approached as if the question were soluble by reference to the law of sales. Dasho v. Susquehanna Corp., 380 F.2d 262, 266 (7 Cir.), cert. denied, Bard v. Dasho, 389 U.S. 977, 88 S.Ct. 480, 19 L.Ed.2d 470 (1967). It is the purpose of the legislation that must be sought. '[A] court's quest must be for what will best accomplish the purposes of the legislature.' Electronic Specialty Co. v. International Controls Corp., 409 F.2d 937, 946 (2d Cir. 1969).' Crane Co. v. Westinghouse Air Brake Co., 419 F.2d 787, 798 (2 Cir. 1969), cert. denied, 400 U.S.822, 91 S.Ct. 41, 27 L.Ed. 2d 50 (1970).

[2] In that quest, two legislative purposes may be thought to emerge. The first is that the intention was to create a statutory right in the nature of an expanded common law of deceit, and that, hence, only the person upon whom the deceit was practiced may sue. The other is that the granting of a private right of action was for the purpose of discouraging violations of the registration requirements of the 1933 Securities Act; and that the reason for limiting recovery to those who 'purchased from' the seller was merely to limit the vast liability that would otherwise

> accrue if the remedy were permitted to be invoked by purchasers after the original transaction was over. Although the matter is not without difficulty in the absence of a statement of legislative intention, I incline to the view that the purpose of affording a private remedy by statute was primarily to discourage the sale of securities without registration.
>
> On any other view, the almost absolute liability imposed for a violation of Section 5 would be defeated by the fortuitous circumstance that the customer became unable to pay, even though someone else did pay and even though the seller pocketed the illegal proceeds. In upholding liability in such case, the standing required of a plaintiff for an action under Section 12 is still not expanded beyond those involved in the first purchase.
>
> Moreover, accepting the allegations of the complaint as true for purposes of this motion, the moving defendants and the plaintiff bank do not stand on the same footing. The former are charged with serious securities violations; the latter is not. In these circumstances, the remedial purposes of the statute are best carried out by permitting the Bank here to stand in the shoes of its defaulting customer. Accordingly, the motion by Barad and Equivest to dismiss count 1 of the complaint is denied."

Nor is it possible to conclude, based upon the undisputed fact that a senior partner of Newburger, Loeb & Co., Leo Stern, reviewed the Buckley account, as well as the accounts of all customers of Newburger, Loeb & Co. and Gross & Co., that Newburger, Loeb & Co was itself guilty of fraud or breach of trust.

In Smith v. Bear, Stearns & Co., 237 F.2d 79 (2 Cir. 1956), this court affirmed judgment for the defendants in a cause of action for breach of contract with respect to the purchase of bonds on margin and for alleged breach of duties owed under the Federal Securities Laws. Plaintiff alleged that Bear, Stearns & Co.through Livingstone & Co. breached certain contracts and acted improperly. Regarding Bear Stearns liability, this court stated;

> "Plaintiff, however, sued Bear, Stearns & Co. to recover these losses. Whether plaintiff can recover against Bear, Stearns & Co. for these wrongful acts, omissions and statements of Livingstone & Co. depends first upon whether Bear, Stearns & Co. 'controlled' Livingstone & Co. within the meaning of § 20(a) of the Securities Exchange Act of 1934, 15 U.S.C.A. §78t(a); and, secondly, the jury having found that the defendants did control Livingston & Co., whether Bear, Stearns & Co. were absolved from liability by virtue of having acted in good faith, and not having directly or indirectly induced the wrongful acts done by Livingstone & Co. On this second point the jury found that defendants acted in good faith and did not directly or indirectly induce the wrongful acts of Livingstone & Co."

In view of the lack of any proof that Leo Stern or any other partner of Newburger, Loeb & Co. acted in bad faith, or directly or indirectly induced

the acts constituting the violation or the cause of action, it cannot be concluded that Newburger, Loeb & Co. was also responsible for the loss.

POINT II

DISMISSAL OF APPELLANT'S CAUSE OF ACTION IN ITS REPLY TO DEFENDANTS' COUNTER-CLAIM SHOULD ALSO BE REVERSED

The trial court dismissed plaintiff's cause of action for damages sustained as the result of the alleged "secret trading" by Charles Gross when he was managing partner of Newburger, Loeb & Co. The court's decision is based upon the acceptance of the testimony of John Settel, a former partner of Newburger, Loeb & Co., and the rejection of the testimony of Ed Rubin, also a former partner (A527). Rubin was characterized as a "disgruntled former partner of Gross." The court found that his testimony was "... completely contradicted not only by other partners (they, too, it should be noted, having no love of Gross), but also by contemporaneous partnership records ...." (id). It is not true that Settel had no "love of Gross." Upon cross-examination of Settel it was shown that he had every reason to be enamored, since he hoped to make a

deal with Mr. Gross (A4557) and had recently discussed this with Gross' attorney.

It is not contended that the trial court's decision was "plainly erroneous." Resolution of the conflict in testimony between Settel and Rubin is illustrative, however, of the logical consequence of the conclusion that a grand conspiracy to injure Charles Gross, Mabel Bleich and Jeanne Donoghue existed -- for if there was such a plan, it necessarily followed that Ed Rubin lied and John Settel told the truth.

POINT III

GRANTING ADDITIONAL DEFENDANTS ON COUNTERCLAIM MUH AND SLOANE'S MOTION WAS CLEARLY ERRONEOUS

On November 17, 1976, upon the letter application of additional defendants Muh and Sloane dated October 12, 1976, the trial court modified the judgment so as to provide that paragraph 2B should not include the names of Robert Muh and Charles Sloane. The court

indicated that it did not find these people liable under that cause of action and stated that their names were inadvertently included in the only submitted judgment, which was unopposed.

If plaintiff's causes of action against defendants remain dismissed and if defendants' counterclaim against plaintiff and others is affirmed, it would be against the interest of Newburger, Loeb & Co., Inc. for defendants Muh and Sloane (or any other defendant) to avoid liability. For this reason, and not because of any view that a conspiracy existed or that damages occurred, it is respectfully urged that the modification by the trial court of the judgment was "clearly erroneous." Rule 10(e) permits the court to correct or modify the record. It does not permit the court to, as here, amend the judgment particularly when, after the filing of a notice of appeal, jurisdiction to do so is exclusively vested in this court. It is also not correct to say that an error occurred. Plain reading of the trial court's decision shows that Muh and Sloane were initially held liable for both punitive damages and the taking of securities allegedly belonging to Mr. Gross.

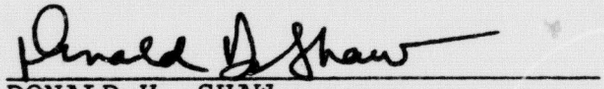
CONCLUSION

No further point is believed necessary to discuss the additional question presented at the outset of this brief -- whether plaintiff's cause of action was so baseless that the trial of this case constituted a further step in a conspiracy, having as one of its prongs the malicious prosecution of Charles Gross, Mabel Bleich and Jeanne Donoghue. To the contrary, fair evaluation of a cause of action based upon facts crying out for justice was prevented through evaluating the action together with motives of attorneys formerly bringing it.

The decision below was erroneous and the judgment entered upon it should be reversed.

Dated: New York, N.Y.
February 4, 1977

Respectfully submitted,



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Of counsel.

 The Reporter Co., Inc., 11 Park Place, New York, N. Y. 10007

THE U.S. COURT OF APPEALS FOR THE SECOND CIRCUIT XXX

NEW BURGER
VS
GROSS

State of New York, County of New York, ss.:

HAROLD DUDASH
agent for kanter shaw & Davidoff , being duly sworn deposes and says that he is the attorney for the above named plaintiff-appellant-appellee herein. That he is over 21 years of age, is not a party to the action and resides at 2346 Holland avenue, BX, NY

That on the fourth day of february , 1977, he served the within brief of the p;laintiff appelants-appellee

upon the attorneys for the parties and at the addresses as specified below

Paul Weiss Rifkind Wharton & Garrison, 345 Park avenue NY, NY
Paul D. Risher, 200 Park avenue' NY, NY
Shaw & Stedina, 350 Madison avenue, NY, NY
Martin E. Silfen P.C. & Bondy & Schloss, 545 Fifth Avenue, NY, NY
Gold FArrell & Marks, 595 Madison Avenue, NY, NY
Osmond K. Fraenkel, 120 Broadway, NY, NY
Lawrence Berkowitz, 10612 Ohio Ave, Los Angelos, Ca 90024
Robert S. Persky, 521 Fifth Ave, NY, NY

by depositing two copies
to each of the same securely enclosed in a post-paid wrapper in the Post Office regularly maintained by the United States Government at
90 Church Street, New York, New York
directed to the said attorneys for the parties as listed above at the addresses aforementioned, that being the addresses within the state designated by them for that purpose, or the places where they then kept offices between which places there then was and now is a regular communication by mail.

Sworn to before me, this ..fourth..... day of february, 1977 1976

ROLAND W. JOHNSON,
Notary Public, State of New York
No. 4509705
Qualified in Delaware County
Commission Expires March 30, 1977

375—Affidavit of Service The Reporter Co., Inc., 11 Park Place, New York, N. Y. 10007

NEW ~~YORK~~ SUPREME COURT APPELLATE DIVISION DEPARTMENT

U.S. COURT OF APEALS FOR THE SECOND CIRCUIT

NEWBURGER
VS
GROSS

AFFIDAVIT OF SERVICE

STATE OF NEW YORK,
COUNTY OF NEW YORK, ss:

BERNARD S. GREENBERG being duly sworn,
deposes and says that he is over the age of 21 years and resides at 162 E 7th St, NY, NY

That on the fourth day of february, 1977 at

he served the annexed brief of plaintiff-appellant-appellee upon

Golden, Weinshienk & Mandel, 10 East 40th Street, NY, ~~NY~~ NY

in this action, by delivering to and leaving with said attorneys
two true cop thereof.

DEPONENT FURTHER SAYS, that he knew the person so served as aforesaid to be the person mentioned and described in the said

Deponent is not a party to the action.

Sworn to before me, this fourth day of february, 1977

Bernard S. Greenberg

ROLAND W. JOHNSON
Notary Public, State of New York
No. 4509705
Qualified in Delaware County
Commission Expires March 30, 1977